City of Rockville Retirement Board

October 15, 2009

PRESENT: Alex Espinosa, Chairperson; Gregory Hazlett, Citizen Representative; Anita McCombs, AAME Representative; Phyllis Marcuccio, Councilmember; Carlos Vargas for City Manager; Kyle France, Union Representative. Also in attendance were Gavin Cohen, Executive Secretary to the Board; Daisy Harley, Personnel Administrator; Debra Daniel, City Attorney; Marsha Mathis, Principal Financial Group via conference phone; Barbara Schlaff and Harry Atlas from Venable, LLP, as well as George Kiriakos and Taylor Dabrowski, Segal Advisors.

ABSENT: Chris Peck, FOP Representative

The meeting commenced at 10:00 a.m. with introductions. Ms. Mathis dialed in and was available by conference call at 10:00. Mr. Cohen thanked Venable for attending.

I. Approval of Minutes from Meeting of September 4, 2009:

Mr. Espinosa asked for a motion to approve the minutes from the September 4, 2009 meeting and Councilmember Marcuccio moved and Ms. McCombs seconded. All were in favor.

II. Principal Contract – Benefit Index:

Mr. Cohen introduced the item and gave a little background. He explained that today's meeting would be to arrive at options and that the November 20, 2009 meeting would be an action meeting. Ms. Mathis was in attendance via conference call. She discussed how the original contract was signed in 1989. She noted that with the help of Hewitt Associates, they revised the Principal contract to guarantee the annuities for the 88 participants in 2002. At that point they resigned the revised contract with this Benefit Index. Basically, there are factors, which are applied to the investments vehicles and as the market conditions and interest rates change, this calculation changes. As of September 30, 2009, the Benefit Index was at approximately $19.3 million. Principal noted that this information was never brought to the Board's attention during any of their strategic asset allocation and diversification discussions and took full responsibility for the lack of communication. Principal noted that there were several opportunities over the past two years where the Benefit Index should have been brought to the attention of the Board, but was not.

Segal requested that this information along with information on the potential purchase of the annuities be presented on a quarterly if not monthly basis to the Board.

Mr. Espinosa expressed concern over the impact on the Board's ability to meet their fiduciary obligations to plan participants. Mr. Kiriakos explained that while the situation did not prevent them from meeting their obligations it did present limits on what they could do. Mr. Vargas further expressed concern that one of the Board's goals was to decrease the business risk of having Principal control so much of the Fund's assets and services. All agreed that the ability to meet this goal was jeopardized by the situation surrounding the Benefit Index.

Mr. Cohen asked Mr. Kiriakos whether Segal Advisors had received the Principal Contract when the engagement began. Mr. Kiriakos said he wasn't sure and had tried to find it, but even had he received it, he would not have known the significance. Mr. Kiriakos acknowledged that even members of his firm received quarterly statements from Principal, but again they were not aware of the significance.

Mr. Cohen asked Segal Advisors to leave the room and the Board discussed whether to continue the relationship with Segal Advisors. Board discussion revolved around the lack of due diligence by Segal Advisors on commencement of the engagement and whether the Board was confident in their ability to serve as advisors due to the strategic asset allocation recommendations that were recommended without knowledge of the impact of the Principal contract. The Board agreed to take this item up at the November 20, 2009 Board meeting.

Segal Advisors were then asked to return to discuss some rebalancing options.

Segal presented the Board with Three Potential Options to solve the situation as well as move forward with the diversification and asset allocation decisions that were decided on at the previous meetings. After a lengthy discussion, the Board decided to move forward with the Third Option, which did not involve the addition of any managers yet allowed them to rebalance the allocation within tolerance ranges using the current Principal funds. The Fund will rebalance back to the target allocation by transferring $4 million from fixed income and moving the assets to large cap ($2 million), small cap ($1 million), and international ($1 million) with the current managers. This will provide them with approximately and $8 million buffering over the required Benefit Index. At the November meeting, the Board will revisit the decision to move fixed income assets to Segall, Bryant & Hamill as well as continue with the search for a new international equity manager. Mr. Kiriakos also discussed that we will review the longer-tem strategic plan, given the current situation we are in, at the next meeting. Ms. McCombs made a motion to implement option 3 to satisfy what is needed right now. Mr. Hazlett seconded it. All were in favor.

Mr. Cohen asked the Board if they had any thoughts on the Board sending Principal a letter to bring them to the table to see what can be done about the contract and to express the Board's dissatisfaction with their lack of communication and the awkward position the lack of communication has put the Board in. Councilperson Marcuccio moved and Mr. Hazlett seconded it. All were in favor.

III. Retirement Board Duties and Responsibilities – Fiduciary Obligations:

Mr. Espinosa stated that he wanted to bring back to the next meeting discussion regarding Retiree COLA and if it should be part of the Board's duties to make COLA recommendations or decision and how to move forward with this. He also wanted to put the vendor search, Segal, Bryant & Hamill, and International Search on hold until November.

IV. Thrift Plan – Mid Cap Fund Replacement:

The Board and Segal discussed an email that was sent by Principal on September 24, 2009 regarding the closing of the current Mid Cap Fund on October 23, 2009. As stated by Principal, if nothing was done the Fund would be automatically mapped to the Principal Mid Cap Blend Separate Account Fund. However, Segal reviewed the options available to the Fund by Principal and all of the fees were much too high. Segal recommended replacing this option with the Principal Mid Cap Index. Segal noted that they believe that it is necessary to give participants 30 days notice of a Fund change. Principal has not allowed that timing with the original date the email was sent. Mr. Cohen is to follow up with regard to participant notification. After some discussion Mr. Hazlett moved to adopt index option. Councilperson Marcuccio seconded it. All were in favor.

V. Discussion for Future Agendas:

The following items will occur at future meetings:

- Board Members Liability Coverage
- Fiduciary Responsibilities
- Review of quarterly performance reports
- Review of Educational Topics – Staff
- Review of Plan Design elements including retirement age, vesting, early retirement, deferred retirement, etc.
- Experience Study
- Plan Date Change
- COLA Methodology – Should RB decide on COLA (Nov 2009)
- VENDOR SEARCH – (Nov 2009)

(Board Members can ask for items to be placed on the agenda)

The meeting was adjourned at 12:30 p.m.